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ACE Research Vignette: New firm formation and job creation by type of firm and type of region

This series of research vignettes is aimed at sharing current and interesting research findings from our team of international Entrepreneurship researchers. This vignette, written by Mr. Darren Kavanagh and Professor Per Davidsson, takes a closer look at job creation by new firms.

Background and Research Question

One of the main reasons for interest in the new firm creation is the impact new firms have on employment. The research presented here takes a deeper look at the generally positive effect of start-ups on employment by examining this relationship by type of start-ups (knowledge-based or not according to OECDs definition, which is based on technology-intensity). The research also considers difference in effects by type of region – more urban vs. more rural. Thus, the research question may be depicted as in Figure 1 and verbally expressed as follows:

Does the level of urbanisation (population density) in a region, and the type of start-up (knowledge-based or not) influence the regional employment effects of start-up activity?

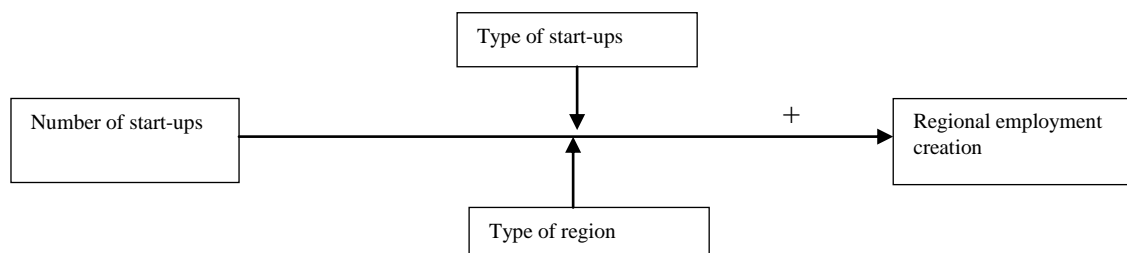


Figure 1: The relationship between the type of start-ups; type of region, and the employment effect of new firm creation

More precisely, the researchers hypothesized that:

Hypothesis 1: Start-ups will have stronger impacts on subsequent employment change in regions with relatively high levels of population density.

Hypothesis 2: Start-ups of knowledge-based enterprises will have greater impact on subsequent employment change than start-ups of other firms, regardless of the regional level of population density.

How was this investigated?

The sample used consisted of new start-ups in Portugal which had at least one wage-earner. The sample was collected from mandatory annual surveys produced by the Portuguese ministry of Labour and Social Solidarity. The data used was collected over a 2 year period to reduce the impact of short-run fluctuations. The way in which the database is set-up allows distinguishing between true start-ups and entry of new plants/business units. The businesses included in the survey consist of businesses start-ups between 1983 and 2000 and excludes the agricultural sector. To compensate for the differences in region size, the employment capabilities are factored in as a ratio of the region. In short, the researcher used a high quality data set and advanced econometric methods to find answers to their questions.



Findings

The researchers find support for both hypotheses: Employment effects are stronger for knowledge-intensive start-ups, and they are stronger in more highly urbanised regions. Further, the difference in effect based on type of start-up is larger than the difference based on type of region.

In particular, differences in the effects of new start-ups on subsequent employment growth between highly urbanised vs. modestly urbanised regions are greater for knowledge-based start-ups than for other types of start-ups. The results suggest that, while knowledge-based start-ups are likely to impart greater benefits on future employment than other types of start-ups, these benefits are greater when those start-ups locate in more urbanised regions.

Business and Policy Advice

It appears from the above research that the type of business start-up has a far greater impact than that of the region. This indicates that the level of employment effects of start-up businesses is more relevant to the type of business start-up than that of the region. This would therefore indicate that in order to increase the level of employment in regions policy makers must look at the type of businesses that are being created in the area. By focusing on creating knowledge-based businesses the levels of employment would appear to increase in that area. This is far from self-evident as higher knowledge-intensity may make the economy more *efficient* and thus reduce the positive effects on numbers of jobs. This idea relates to the idea that geographic location has an effect on availability resources. By increasing the levels of knowledge-based businesses the requirement of resources are reduced and therefore the success of businesses would become greater.

As this study was only carried out the Portugal it may be useful in the future to consider the impacts on other countries that have very different dynamics in their regions. To the extent that the results are valid for Australia they roughly translate to suggesting that employment effects of start-ups are stronger in the major metropolitan areas than in the rest of the country. However, the more important issue is the knowledge-intensity of the new start-ups, regardless of which region they locate in. All regions can benefit from increased start-up activity, but especially much so if a significant proportion of these start-ups are knowledge-intensive. Policy makers will therefore be able to discover the relevancy of the findings to their own country.

This research vignette was written by: Mr. Darren Kavanagh and Professor Per Davidsson, Director of ACE (<http://staff.qut.edu.au/staff/davidssp>), based on the article referenced below.

Check the source & learn more from: Baptista, R. & Preto, M.T. (2009). New firm formation and employment growth: Regional and business dynamics. *Small Business Economics*, 36(4), 419-442. doi: 10.1007/s11187-009-9254-y